

Message Text

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ACTION EA-14

INFO OCT-01 EUR-25 ISO-00 SPC-03 AID-20 EB-11 NSC-10

RSC-01 CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02

CIAE-00 COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12

LAB-06 SIL-01 DODE-00 PA-04 USIA-15 PRS-01 AGR-20

NIC-01 DRC-01 /198 W

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R 170030Z DEC 73

FM AMCONSUL HONG KONG

TO SECSTATE WASHDC 9008

INFO USLO PEKING

AMEMBASSY TOKYO

AMEMBASSY TAIPEI

AMEMBASSY SEOUL

AMEMBASSY MANILA

AMEMBASSY JAKARTA

AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY BONN

C O N F I D E N T I A L HONG KONG 12621

PASS TREASURY FOR BENNET AND HENNESSY

E.O. 11652: GDS

TAGS: EFIN, ETRD, CH

SUBJECT: PRC ECONOMY, ECONOMIC POLICY AND BALANCE OF PAYMENTS

1. FOLLOWING IS INTRODUCTION AND SUMMARY OF HK A-322 ENTITLED
PRC ECONOMY, ECONOMIC POLICY AND BALANCE OF PAYMENTS.

2. PURPOSE OF PAPER IS (A) REVIEW BRIEFLY KEY FACTORS INFLUENCING
CHINA'S BALANCE OF PAYMENTS (ESSENTIALLY DEVELOPMENT OF EXPORTS) IN
PERIOD 1949-70, AND (B) DISCUSS WHAT KIND OF BALANCE OF PAYMENTS
STRATEGY COUNTRY MAY NOW BE FOLLOWING IN LIGHT OF TRENDS OBSERVABLE
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IN THE PERIOD 1971-1973. PRINCIPAL CONCLUSIONS ARE:

(A) IN PERIOD 1949-1970 CHINA'S NATURAL ENDOWMENT FOR LIGHT INDUSTRY, I.E., ITS LARGE SUPPLY OF CHEAP, INDUSTRIOUS AND RELATIVELY WELL EDUCATED LABOR, AND ITS EARLY ABILITY TO MOBILIZE RESOURCES FOR INVESTMENT AND GROWTH, LED TO RAPID RISE OF EXPORTS IN THE FIFTIES. THEN CHINA WAS STRUCK EXTERNALLY BY ABRUPT RUSSIAN WITHDRAWAL OF ASSISTANCE AND NEED TO REDIRECT TRADE FROM COMMUNIST TO NON-COMMUNIST COUNTRIES. INTERNALLY, AFTERMATH OF GREAT LEAP FORWARD AND CULTURAL REVOLUTION EFFECTED PRODUCTION AND POTENTIAL FOR EXPORTS AND CAUSED AN INWARD TURNING OF POLICY WHICH INEVITABLY LOWERED PRIORITY OF EXPORTS. THROUGHOUT PERIOD, COLD WAR WITH THE UNITED STATES DEPRIVED IT OF ACCESS TO GREATEST MARKET EFFECTS ON TRADE WITH JAPAN, THE PHILIPPINES AND THAILAND. RESULT WAS STAGNATION OF EXPORTS AND IMPORTS.

(B) CHINESE TRADE HAS LARGELY STAGNATED FROM 1959 UNTIL 1972 AND ITS RELATIVE IMPORTANCE AS TRADER HAS FALLEN AS COMPARED TO OTHER LDCS AND OTHER ASIAN COUNTRIES. EXPORTS REMAIN TINY PERCENTAGE OF GNP. CHINA BORROWED EXTENSIVELY IN FIFTIES FROM COMMUNIST BLOC AND FROM WESTERN COUNTRIES ON MUCH SHORTER TERMS IN EARLY SIXTIES. BY END 1972, DEBT OUTSTANDING WAS RELATIVELY LOW AND IT WAS IN POSITION TO BORROW MUCH MORE EXTENSIVELY.

(C) SINCE 1971, NEW EXPORT DRIVE HAS BEEN UNDERWAY WITH SALES RISING 20 PERCENT IN 1971, 25 PERCENT IN 1972 AND PROBABLY AT SUBSTANTIALLY HIGHER RATE THIS YEAR. CHINA'S CHEAP LABOR, GREATER ACCESS TO JAPANESE MARKET, OPENING OF US MARKET AND ITS SOMEWHAT GREATER WILLINGNESS TO ADJUST TO OTHER COUNTRIES REQUIREMENTS GIVE IT RELATIVELY STRONG POSITION OVER TIME AS EXPORTER OF LABOR INTENSIVE PRODUCTS. IT HAS BORROWED ABOUT \$650 MILLION WORTH OF MEDIUM-TERM CREDITS IN PAST YEAR, AND IS IN POSITION TO BORROW MUCH MORE. IN SUM, COUNTRY SEEMS TO BE FOLLOWING POLICY OF EXPANDING EXPORTS TO ACQUIRE CERTAIN CAPITAL GOODS MORE CHEAPLY THAN THEY COULD BE PRODUCED DOMESTICALLY AND ON

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PATTERN OF BORROWING THAT WILL EVENTUALLY LEAD TO IMPORT SURPLUS FOR AT LEAST A FEW YEARS WITH NON-COMMUNIST COUNTRIES.

(D) IMPORTANCE OF LIGHT INDUSTRIAL OR LABOR INTENSIVE PRODUCTS IN ITS PRESENT EXPORT STRUCTURE MEANS THAT OIL MAY BE RELATIVELY LESS SIGNIFICANT IN RISE OF EXPORTS OVER NEXT FEW YEARS. IT WOULD PROBABLY ALSO

HAVE CONSEQUENCE OF MAKING MFN TREATMENT BY US OF
IMPORTS FROM CHINA A REAL ECONOMIC ISSUE IN SAME PERIOD.

(E) POLICY OF TRADE EXPANSION AND MEDIUM-TERM BORROWING IS
A DEPARTURE FROM THAT OF LATE SIXTIES. IT PRESUPPOSES
A GREATER COMMITMENT TO ECONOMIC GROWTH AND PROBABLY
AT LEAST A FIVE YEAR CONTINUING EFFORT TO BEAR
FRUIT. IT, THEREFORE, RUNS THE DANGER THAT IT
MAY BE UPSET OR SLOWED DOWN BY "LEFTIST" REACTION.

(F) CHINA SEEMS TO HAVE FAIRLY FIRM GRASP OF ITS FUTURE
RECEIPTS AND PAYMENTS AND IS NOT LIKELY TO SUFFER A
SIGNIFICANT BALANCE OF PAYMENTS DEFICIT IN NEXT 6-9
MONTHS THAT WOULD REQUIRE IMPORT RETRENCHMENT. IT
HAS ALREADY TAKEN ACTION TO WORK OUT TRADE CREDIT
ARRANGEMENTS PARTICULARLY WITH JAPAN AND IS
EXPLORING POSSIBILITY OF ADDITIONAL FINANCIAL
CREDITS BASED ON EURODOLLAR MARKET. IN
EVENT THAT UNEXPECTED SHORTFALL IN RECEIPTS TAKES
PLACE, IT COULD BORROW AT HIGH INTEREST RATES OR
DRAW ON RESERVES. OVER SLIGHTLY LONGER RUN (12-18
MONTHS) TRADE DEFICIT (AT LEAST WITH NON-COMMUNIST
COUNTRIES) SHOULD BEGIN TO DEVELOP, FINANCED BY
AN INFLOW OF CREDIT LARGELY OF TRADE TYPE BECAUSE
INTEREST RATES ARE SUBSIDIZED BY EXPORTER COUNTRIES.
THERE WILL PROBABLY ALSO BE AN ELEMENT OF FINANCIAL
CREDIT DERIVING ULTIMATELY FROM EURODOLLAR MARKET
THROUGH INTERMEDIARY OF JAPANESE, EUROPEAN AND
EVENTUALLY US BANKS.

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